National Audit Office

Report
by the Comptroller
and Auditor General

HM Revenue & Customs

Gift Aid and reliefs on donations

HC 733 SESSION 2013-14 21 NOVEMBER 2013

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National Audit Office

HM Revenue & Customs

Gift Aid and reliefs on donations

Report by the Comptroller and Auditor General

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Comptroller and Auditor General
National Audit Office

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This study examines how HMRC monitors and evaluates the effectiveness of reliefs on donations, and how it addresses tax avoidance, fraud and error relating to these reliefs.

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Contents

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This report can be found on the National Audit Office website at www.nao.org.uk/2013-gift-aid

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Key facts

£2bn

cost to Exchequer of tax reliefs on donations provided to charities, individuals and companies in 2012-13

£217m

tax at risk from marketed avoidance schemes on claims dating from 2004 onwards

£170m

HMRC's rough estimate of tax lost through abuse of the reliefs, 2012-13

Where the reliefs go

£1 billion	the value of Gift Aid relief HMRC paid to charities in 2012-13, about 2 per cent of all charity income
£940 million	tax relief provided to individuals and businesses on their donations to charity in 2012-13

HMRC's administration of the reliefs

1,800	open avoidance cases relating to marketed schemes that use the reliefs
£63 million	of loss HMRC prevented from examinations of the reliefs provided to charities in 2012-13, up from £15 million in 2009-10
£9.7 million	the cost of administering Gift Aid and other reliefs for charities, 2012-13
£44	the amount of tax that HMRC's charities team estimates that it recovered for every £1 of direct spend on compliance work in 2012-13

Summary

The context for this report

1 The government collects taxes to fund public services, and help individuals, households and businesses with targeted financial support. Government can use the taxation system to redistribute wealth and influence behaviour. It must also keep the tax system competitive to protect tax revenue and support economic growth.

2 All tax systems include tax reliefs, which are rules intended to reduce an individual's, charity's or company's tax liability. HM Treasury is responsible for strategic oversight of the tax system. HM Treasury and HM Revenue & Customs (HMRC) work together in a policy partnership on the development of tax policy, including the design of tax reliefs. HMRC administers the tax system, and is responsible for the maintenance of tax policy, providing advice on the design of tax rules and monitoring their application.

3 There is no official categorisation of different forms of tax relief, but in its published statistics HMRC identifies relief on the income of charities as one of a subset of tax reliefs it calls 'tax expenditures'. Tax expenditures include a broad range of reliefs, described by HMRC as reliefs "to help or encourage particular types of individuals, activities or products. Such reliefs are often an alternative to public expenditure, and have similar effects". HMRC has incomplete data on the costs of these reliefs but identifies 47 principal tax expenditures, which range in value from £50 million a year for the smallest to £20 billion for the largest.

4 As government's auditors we would reasonably expect to see evidence of an effective system of controls to design, manage and evaluate the use of a tax expenditure which is rigorous and proportionate, and would share many of the features that we would expect for a spending programme. For example: an adequate evidence base is available to support decisions over design of the relief or changes to it, including lessons learnt from evaluations of other reliefs; there is clarity about how government intends to monitor and assess the cost and impact of the relief and evaluate its outcomes; and, adequate safeguards are in place to prevent excessive leakage through abuse and error.

5 This report examines whether the way Gift Aid and other reliefs on donations to charity are administered by HMRC and evaluated by the exchequer departments meet these criteria. We have examined Gift Aid and tax reliefs on donations in particular following the Committee of Public Accounts' (the Committee) concern about the potential scale of abuse of reliefs on donations to charity. In June 2013, the Committee concluded that the Cup Trust charity was part of a tax avoidance scheme which put over £46 million of tax at risk through claims for Gift Aid relief.[1] We are reporting separately on the questions the Cup Trust raised about the Charity Commission's effectiveness as a regulator of charities.

How Gift Aid and reliefs on donations work

6 Successive governments have legislated to exclude charities from income tax, including income from donations, since the first permanent Income Tax Act of 1842. Gift Aid reflects this principle and is one of the largest tax reliefs available to charities. It provides an important source of income to charities, representing around 2 per cent of total charities' income.

7 When individuals make a donation, the charity may ask them to complete a Gift Aid declaration, authorising the charity to claim Gift Aid. The donor needs to be a UK taxpayer and to have paid enough income tax or capital gains tax to cover the amount the charity will reclaim on the donation. The charity claims a repayment from HMRC of the basic rate tax that the donor is deemed to have paid on the sum donated. If the donor is a higher or additional rate taxpayer, the donor can also claim relief on the difference between their highest tax rate and the basic rate (**Figure 1**).

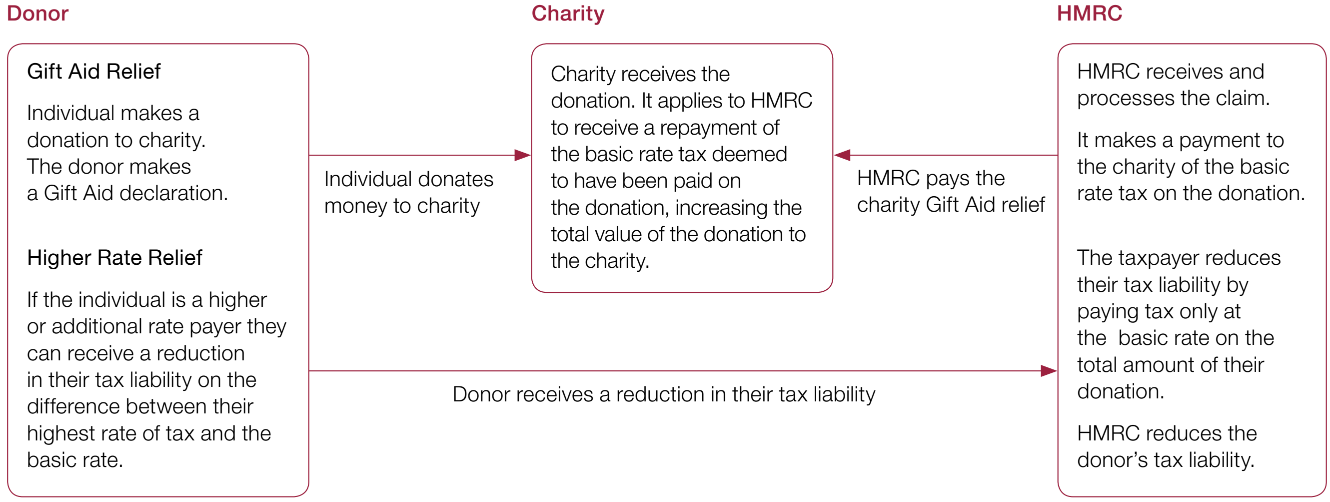
8 There are also reliefs available to individuals and companies when they donate certain shares and other qualifying investments to a charity (hereafter referred to as Gift of Shares and Securities) and to companies when they donate money. Charities do not receive a repayment from HMRC on these donations; instead the reliefs reduce the donor's taxable income by the value of the donation. The four reliefs on donations covered by our report are shown in **Figure 2**.

9 It is important that tax reliefs on donations are well administered to protect the reputation of the charitable sector and give confidence to donors. In common with many other tax reliefs, reliefs on donations are susceptible to abuse and error. HMRC runs checks to manage losses from such abuse and to act as a deterrent. HMRC has a dedicated charities team which is responsible for coordinating HMRC's work on the tax affairs of charities.

1 HC Committee of Public Accounts, *Charity Commission: the Cup Trust and tax avoidance*, Seventh Report of Session 2013-14, HC 138, June 2013.

Figure 1
Gift Aid relief provides a repayment of tax to charities

Higher rate taxpayers can also receive a reduction in their tax liability



Source: National Audit Office review of HM Revenue & Customs guidance

Figure 2
Main reliefs on donations to charity and recipients

Relief	Description	Recipient of relief	Example
Gift Aid relief	A gift of money to a charity from an individual who pays UK tax. The charity can reclaim the basic rate of tax paid on the donation.	The charity	On a £100 donation the charity can reclaim £25. The total value of the donation to the charity is £125.
Higher Rate relief	Higher rate and additional rate taxpayers can reclaim the difference between their highest rate of tax and the basic rate on donations made under Gift Aid.	Higher rate taxpayers	On a £100 donation a higher rate taxpayer can reclaim £25. An additional rate taxpayer can reclaim £31.25.
Corporate Gift Aid	A gift of money to charity. Companies can reduce their taxable income by the amount donated.	Companies	A company donates £100 to charity and reduces its taxable income by the same amount.
Gift of Shares and Securities	Individuals or companies donating shares and securities can reduce their taxable income by the value of the gift.	Mostly affluent individuals and companies	An individual donates £100 of shares to charity and reduces their taxable income by the same amount.

Source: HM Revenue & Customs guidance on giving to charities

10 The main risks of the reliefs being applied in a way Parliament did not intend are:

- **Fraud.** Criminals may falsify donations to generate a repayment of Gift Aid relief. They may set up a charity to facilitate the fraud, hijack the details of a charity, or use a position of influence in an existing charity.
- **Avoidance activity.** Companies and individuals may create ways to avoid tax particular to their circumstances. Avoidance schemes may also be marketed by promoters on the basis that they provide the scheme user with a potential tax benefit that is greater than the true value of the donation. Other schemes operate by extracting the value of the donations from the charity.
- **Error.** For example, charities may mistakenly submit incorrect details or duplicate claims or claim relief when the donor did not authorise Gift Aid. Individuals may also sign a Gift Aid declaration when they have not paid enough tax for their donation to qualify.

The scope of this report

11 This report examines:

- the costs and effectiveness of Gift Aid and reliefs on donations in meeting their objectives (Part One); and,
- HMRC's response to the abuse of the reliefs (Part Two).

Our audit approach and evidence base are summarised at Appendices One and Two.

Key findings

Objectives, costs and effectiveness

12 Gift Aid is an important source of income for charities, having largely displaced other reliefs on donations paid to charities by HMRC. Charities identify Gift Aid as an essential fundraising tool. As the value of Gift Aid payments has increased, it has as intended largely displaced other forms of relief, such as that previously available on covenants. In real terms, the amount paid to charities in respect of reliefs on donations increased between 1990 and 1999 but fell following changes made to Gift Aid in April 2000 which extended the range of the reliefs and redirected some relief from the charity to the donor. The amounts paid to charities have since risen to over £1 billion a year, similar in real terms to their value in the late 1990s before these changes took effect (paragraphs 1.4 to 1.10).

13 **The government has multiple objectives for reliefs on donations.** Tax relief on donations reflects a long-held principle, consistently accepted by Parliament, that charitable income should be exempt from taxation where that income is used for charitable purposes. Gift Aid and other reliefs on donations are current mechanisms for achieving this. They encompass a wider set of objectives, such as making the taxation system simpler for charities and donors to use and encouraging more giving by making donations more tax efficient (paragraphs 1.4 to 1.6).

14 **Since Gift Aid was reformed in 2000, there has been a significant increase in the costs of reliefs claimed by donors, but HMRC does not know if the changes have met the objective to encourage more charitable giving.** Adjusted for inflation, charities received £1,060 million in tax relief on donations in 1999-2000, and donors received £130 million; in 2012-13, charities received £1,040 million, and donors around £940 million. The changes in 2000 broadened access to tax efficient giving and made the tax system simpler for charities and donors to use, supporting the broad principle of exempting charitable income from taxation. When the changes were made, however, the exchequer departments did not establish a framework, or set out to collect data, by which they could have evaluated their wider effects. HMRC has since undertaken research on the impact of the changes, but the evidence they had collected was not robust enough to provide assurance that the incentives have met the objective to encourage more people to give more to charity. Research from the charitable sector is inconclusive about how patterns of giving have changed, but there is no evidence of a causal link between the changes to the reliefs and the value of donations (paragraphs 1.11 to 1.17).

15 **Government has not set out what good performance would be.** The broad objectives of the reliefs to widen access and simplify the tax system could be met even if HMRC's performance in administering them was poor. For example, though it has commissioned research to understand the barriers to take-up, HMRC has not identified what level of take-up of Gift Aid should be achievable. A rise in the uptake of Gift Aid among donors by ten percentage points could result in charities receiving an additional £94 million in relief. This would involve changing the behaviour of some 2.5 million donors (paragraphs 1.4 to 1.6 and 1.18 to 1.19).

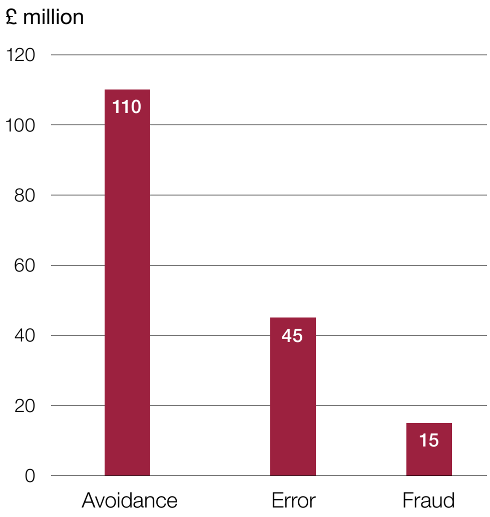
16 **HMRC does not have an accurate estimate of how much tax is lost through avoidance, fraud and error in respect of reliefs on donations.** HMRC has produced a working estimate that £170 million was lost in 2012-13 based on its analysis of tax loss in related areas. However, it recognises that its methodology is crude and may understate the level of loss. For example, donors need to have paid tax in order for charities to reclaim payments of Gift Aid. Our analysis suggests that HMRC may be paying a further £55 million in error where the donor has paid insufficient tax to allow the charity to claim Gift Aid. HMRC plans to undertake a full analysis of the losses in respect of reliefs on donations in autumn 2013 (paragraphs 1.24 to 1.25).

HMRC's response to abuse of the reliefs

17 **HMRC faces a serious compliance challenge in respect of reliefs on donations, in particular from avoidance.** Our analysis of HMRC's estimate of losses in 2012-13, shows that the largest losses occurred through avoidance activities such as, for example, the misuse of Higher Rate relief (**Figure 3** and paragraphs 1.24 to 1.25).

Figure 3
Estimate of losses in 2012-13

Avoidance accounts for the largest losses from tax reliefs on charitable donations



Note

1 The figures are after any activities HMRC has taken to reduce losses. The figures exclude tax at risk through marketed avoidance schemes as HMRC does not expect any of these claims to succeed. HMRC does not categorise its losses as 'avoidance', 'error' or 'fraud'. The split is based on National Audit Office analysis of the recorded figures.

Source: National Audit Office analysis of HM Revenue & Customs data

18 **Significant sums are at risk from marketed avoidance schemes, though HMRC is confident it can counter this threat.** HMRC has identified eight marketed avoidance schemes that fall into three broad categories, estimating that they put £240 million of tax at risk. Following its investigations, 200 users have since withdrawn claims to the value of £23 million. There remain 1,800 open cases, representing approximately 5 per cent of all avoidance cases HMRC is investigating across the tax system and about 2 per cent of the value. HMRC is challenging these claims and does not expect any to succeed when heard at tribunal so therefore does not estimate any tax loss will result from the claims (paragraphs 2.9 and 2.40).

19 **It is more difficult for HMRC to detect and counter the avoidance activities of individuals or companies that do not rely on marketed schemes.** Those charities that are used as vehicles for tax avoidance are generally unfamiliar to most people and do not receive donations from the general public. While a very small proportion of charities are set up to abuse charitable status, the cumulative costs of small-scale avoidance activity are large, accounting for £110 million of tax lost in 2012-13 (paragraphs 2.7 to 2.8 and 2.33).

20 **HMRC estimates that compliance work by its charities team prevented the loss of £63 million of tax at risk from the abuse of reliefs on donations in 2012-13, a four-fold increase since 2009-10.** Before 2009, HMRC's emphasis had been on quickly processing Gift Aid claims so that charities received the repayments quickly, and few security checks were undertaken. Recognising the risks that this posed, it introduced a new strategy in 2009 to tackle fraud, strengthened its manual checks on repayments, and introduced controls to reduce mistakes and better identify fraudulent claims (paragraphs 2.24 to 2.27 and 2.44).

21 **In 2012-13, HMRC prevented £44 of tax loss for every £1 spent on staff checking Gift Aid claims and charities' tax affairs for compliance, but does not know if it has the optimal level of resourcing.** A doubling of compliance staff since 2009-10 has increased this ratio from 21:1 to 44:1, which compares favourably with HMRC's rule of thumb that investment in compliance work should provide a marginal return of around 11:1. HMRC's charities team is considering revisions to its staffing model to increase the impact of its work (paragraph 2.45 to 2.48).

22 **Acting on HMRC's advice, the government has made changes to tax law which have helped to prevent the abuse of reliefs.** HMRC recommended changes, which government introduced, to stop the exploitation of reliefs on donations following the identification of specific tax avoidance schemes in 2004 and 2009. It believes these changes have prevented additional people from using the schemes while deterring attempts to establish new schemes. Government introduced legislation in 2010 to allow HMRC to apply a 'fit and proper persons' test to the managers of charities, giving it the power to refuse claims for tax reliefs and exemptions from existing charities. On each of the around 200 occasions it has raised questions in relation to this test, the application has been withdrawn (paragraphs 2.14 to 2.15 and 2.31 to 2.32).

23 **HMRC does not combine all the information it holds about the operation of reliefs on donations, and so lacks a complete picture of the nature of the risks and the cost and impact of its interventions to counter them.** While the HMRC's charities team is responsible for the risks relating to the tax affairs of charities and processes Gift Aid claims, claims for relief on donations by individuals and businesses are processed by other parts of HMRC's business. The charities team does not have oversight of these checks and other teams in HMRC are not required to pass on information about relevant investigations or the impact or cost of their interventions. HMRC's information on the losses it has stopped is therefore incomplete. In 2012-13, it identified that it had stopped £15 million in fraudulent Gift Aid claims by charities and £31 million on claims by charities containing or made in error. However, it did not collect data on how much avoidance or error it stopped relating to individuals claiming Higher Rate relief or companies claiming Corporate Gift Aid (paragraphs 1.21, 2.16 to 2.19 and 2.44 to 2.46).

24 **There remain gaps in HMRC's knowledge about its charity customers that prevent it from tailoring its interventions most effectively.** HMRC does not currently hold important information about charities claiming tax reliefs, including details of their activities, income, expenditure and assets, and has not maximised its potential to learn more by sharing information with the charity regulators, such as the Charity Commission for England and Wales. HMRC currently requires around 10 per cent of charities that have made recent Gift Aid claims to make a tax return, and intends to increase the number of charities it asks for this information to improve its profiling of customers and assessments of risk. This will allow HMRC to better target those claims which present a risk (paragraphs 2.34 to 2.37).

Conclusion on value for money

25 Gift Aid provides an important source of income for many charities and reflects Parliament's intention that the income of charities should not be taxed where it is used for charitable purposes. There is welcome evidence that HMRC has strengthened its measures to counter the risk of the abuse of reliefs on donations. However, there is insufficient evidence to conclude that reliefs on donations in their current form, and the way they are implemented, provide value for money.

26 First, there is insufficient evidence that government actively encourages take-up of these reliefs so that those charities which are entitled to them receive the intended benefits. Second, the effectiveness of changes made in 2000 to increase charitable giving is not proven. HMRC's research on the impact of the changes does not allow a clear conclusion to be drawn, and there is an absence of evidence that would demonstrate that the increased cost to the exchequer has resulted in an increase in the value of donations to charity.

Recommendations

a **HMRC and HM Treasury should collect better evidence on the impact of reliefs on donor behaviour, working with the charitable sector and academics to obtain this.** The evidence so far collected has not been sufficient to conclude on whether the incentives provided to donors are working as intended, or whether Gift Aid makes the tax system sufficiently easy for charities to claim the relief. Greater joint working with the charitable sector on data collection and analysis could provider a richer evidence base from which to assess the impact of reliefs.

b **When changes are made to the rules governing tax expenditures, HM Treasury and HMRC should consider what evidence will be required for evaluation and put in place mechanisms to collect it.** HMRC should consider what is proportionate and feasible for it to collect in order to assess whether the stated objectives are being met; to inform potential changes that might improve the relief's effectiveness; and to provide an evidence base to inform the design of other reliefs.

c **HMRC should undertake regular assessments of the losses from Gift Aid and reliefs on donations.** HMRC plans to undertake a full assessment of the losses for charity tax reliefs in autumn 2013. HMRC should assess the costs of undertaking this assessment against the benefits of the information it provides and should consider how best to update the estimate in future.

d **HMRC should evaluate ways to reduce losses from avoidance.** HMRC has successfully increased the impact of its interventions, but more focus is required on tackling avoidance.

e **HMRC should ensure there are better internal flows of information to its charities team.** The team with overall responsibility for charities should establish formal agreements with other parts of the business to ensure full information and data sharing. This should include providing better management information on yields.

f **HMRC needs to better understand its customers in the charitable sector in order to improve its ability to identify risk.** HMRC is planning to obtain more information on its customers. HMRC should develop more detailed customer profiles to help it assess which charities, individuals or companies require review.

g **HMRC should work more closely with the Charity Commission and other regulators of charities to identify and resolve potential problems with the tax affairs and running of charities.** They need to share information more effectively and collaborate on the risk profiling of charities. To do so they will need a better mutual understanding of the organisations' information requirements and ways of working.

Part One

The costs and effectiveness of Gift Aid and other reliefs on donations in meeting their objectives

An overview of tax reliefs

1.1 All tax systems include tax reliefs, which are rules intended to reduce an individual's, charity's or company's tax liability. HM Treasury is responsible for strategic oversight of the tax system. HM Treasury and HM Revenue & Customs (HMRC) work together in a policy partnership on the development of tax policy, including the design of tax reliefs. HMRC administers the tax system, and is responsible for the maintenance of tax policy, providing advice on the design of tax rules and monitoring their application.

1.2 There is no official categorisation of different forms of tax relief, but in its published statistics HMRC identifies relief on the income of charities as one of a subset of tax reliefs it calls 'tax expenditures'.[2] Tax expenditures include a broad range of reliefs, described by HMRC as reliefs "to help or encourage particular types of individuals, activities or products. Such reliefs are often an alternative to public expenditure, and have similar effects". HMRC has incomplete data on the costs of these reliefs but identifies 47 principal tax expenditures, which range in value from £50 million a year for the smallest to £20 billion for the largest.

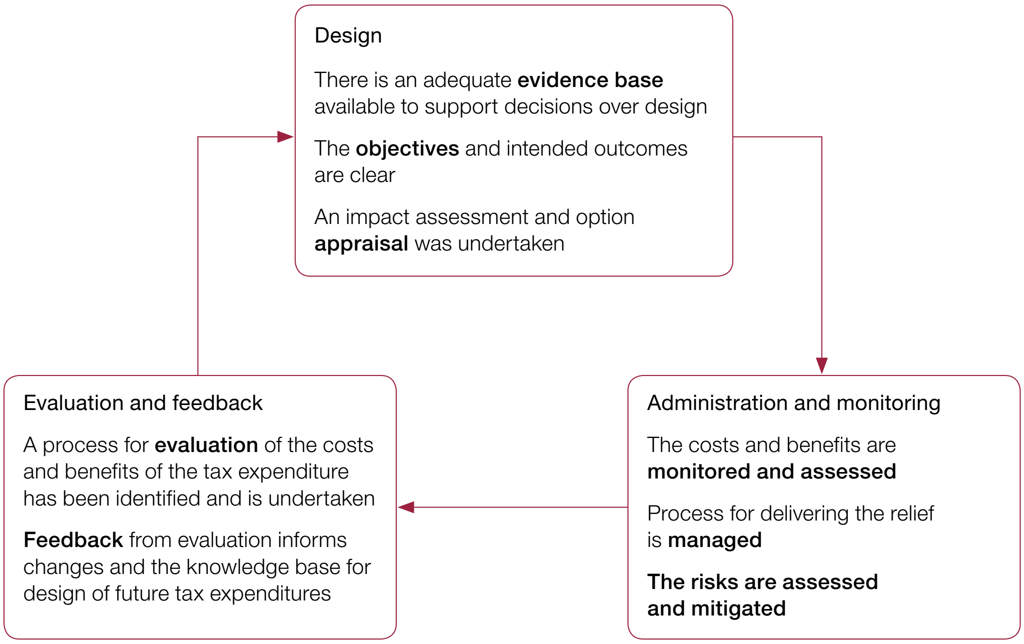
1.3 As government's auditors we would reasonably expect to see evidence of an effective system of controls to design, manage and evaluate the use of a tax expenditure, which is rigorous and proportionate, and would share many of the features as we would expect for a spending programme. For example: an adequate evidence base is available to support decisions over design of the relief or changes to it, including lessons learnt from evaluations of other reliefs; there is clarity about how government intends to monitor and assess the cost and impact of the relief and evaluate its outcomes; and, adequate safeguards are in place to prevent excessive leakage through abuse and error (**Figure 4**). We outline our assessment of Gift Aid and reliefs on donations against these criteria in Appendix Three.

2 HMRC describes this further in HM Revenue & Customs, *Tax Expenditures and Ready Reckoners*. Available at: www.hmrc.gov.uk/statistics/expenditures/introduction.pdf, accessed 23 October 2013.

Figure 4

Characteristics of a well-designed, administered and evaluated tax expenditure

HM Treasury provides guidance for appraisal and evaluation



Source: National Audit Office summary of HM Treasury, *The Green Book, appraisal and evaluation in Central Government*, July 2011, and HM Treasury, *Magenta Book, guidance for evaluation*, April 2011

The objectives of Gift Aid and reliefs on donations to charity

1.4 Successive governments have legislated to exclude charities from income tax, including income from donations where the income is used for charitable purposes, since the first permanent Income Tax Act of 1842. Gift Aid reflects this approach and allows charities to claim the basic rate tax that donors have paid on their donations. Tax reliefs on donations have a wider set of objectives, which have evolved over time as rules on eligible donations were changed and reliefs which can be claimed by individuals and companies on their donations were introduced and amended. These wider objectives include making the tax system simpler for charities and donors to use, and encouraging more giving by individuals and companies. The objectives of the main Gift Aid scheme were most recently stated in a consultation on Digital Giving in July 2013 (**Figure 5** overleaf).

Figure 5
Government statements on the purpose of Gift Aid and reliefs on donations

Year and source	Government statement
1990	
Chancellor's budget statement	"I propose a Gift Aid scheme that will, for the first time, give tax relief for large money donations. …I do not wish to undermine regular giving through the payroll scheme and covenants, which are very important to some charities. Therefore, this scheme applies to larger donations."
1999	
Pre-budget statement which announced the intention to make Gift Aid available for donations of any size and to introduce Gift of Shares and Securities and Corporate Gift Aid	Changes introduced from April 2000 in charity taxation "to encourage more individuals and businesses to give more, and to make the taxation system simpler for donors and charities to use."
2007	
Consultation on Gift Aid	Gift Aid is a tax relief that was introduced in 1990 to encourage gifts of money to charities.
2013	
Consultation on Digital Giving	The government wants to encourage more people to donate by increasing the value of their gift, and to maximise the possible income to charity from each donation they receive. The government therefore wants Gift Aid to be claimed on as many donations as possible.

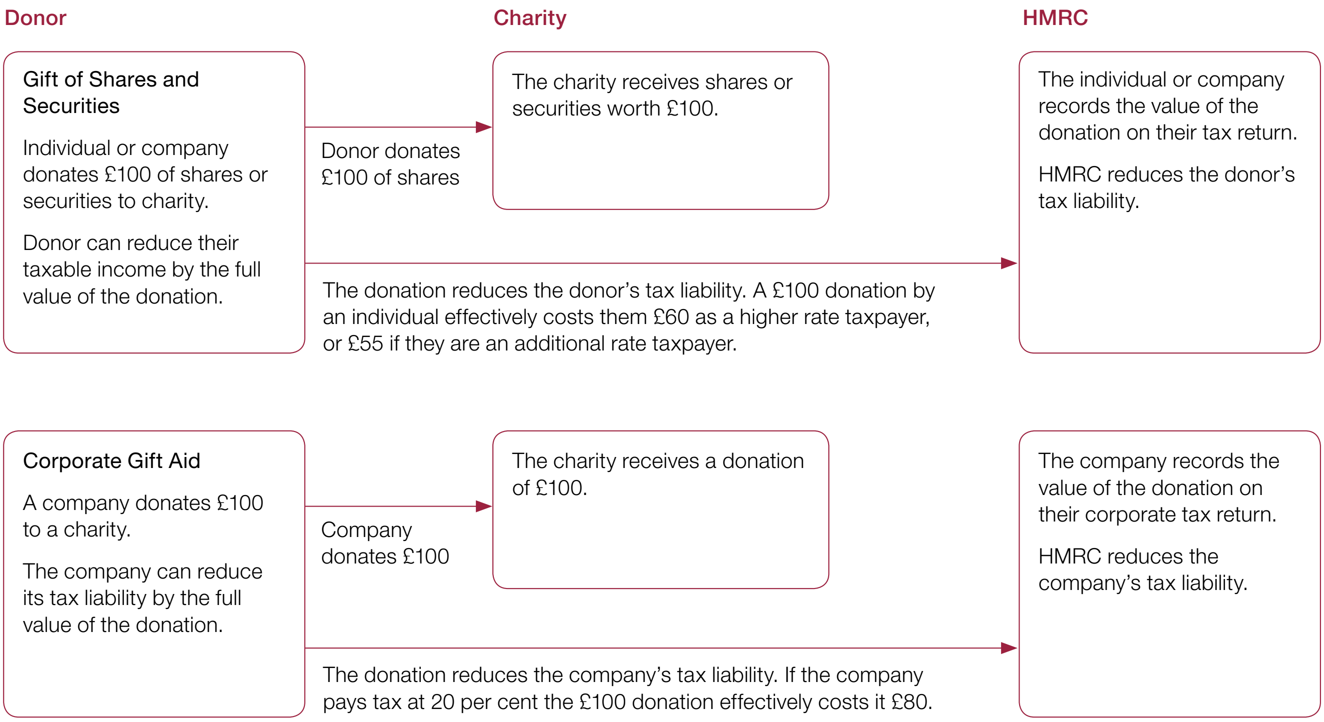
Source: National Audit Office analysis

1.5 The government introduced the first Gift Aid scheme in 1990, initially to support one-off donations to charities with only large donations qualifying. This scheme was designed to operate alongside existing reliefs available to charities, such as donations through covenants, which was the main mechanism to provide tax relief to charities on the donations they received.

1.6 In 2000, the government made several changes intended to broaden access to tax reliefs on donations, simplify the tax system for charities and donors, and encourage more donations to charity. These changes left in place a range of tax reliefs to replace those that had been available through deeds of covenant. Separate reliefs on donations for Gift of Shares and Securities were introduced and Corporate Gift Aid was reformed; the donor rather than the charity receives the relief on these donations. Prior to 2000, charities could claim relief on donations from companies, and the change ended this particular relief for charities. **Figure 6** shows how Corporate Gift Aid and Reliefs on Shares and Securities work. Tax reliefs on donations allow donors to donate greater amounts to charity at the same net cost, or to donate the same amount more cheaply.

Figure 6

Reliefs on Gift of Shares and Securities and Corporate Gift Aid are designed to reduce the cost of giving for individuals and companies



Source: National Audit Office review of HM Revenue & Customs guidance

Cost and effectiveness of the reliefs

1.7 The government spends substantial amounts of money through tax reliefs on donations. HMRC paid around £1 billion in Gift Aid relief to charities in 2012-13, while individuals through Higher Rate relief on Gift Aid donations claimed £470 million of relief. Individuals reduced their tax liabilities by a further £70 million through Gift of Shares and Securities relief. HMRC's rough estimate of the cost of Corporate Gift Aid was around £400 million. **Figure 7** overleaf shows how the cost of tax reliefs has increased over time. This excludes the cost of Corporate Gift Aid after 2000 as HMRC does not hold time series data after this point.

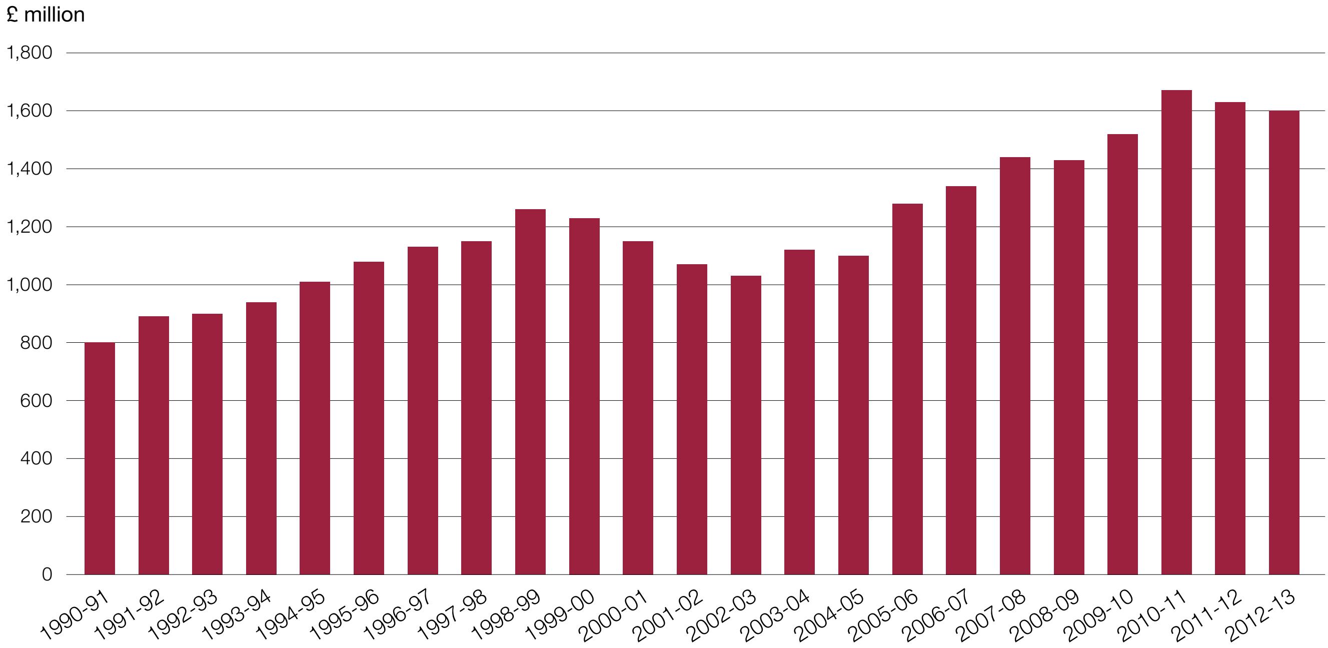
The impact of the reliefs on charities' income

1.8 Since Gift Aid was introduced the total value of donations where Gift Aid is applied has steadily increased. The value of Gift Aid relief for charities has increased from around £290 million a year in 2000-01 to over £1 billion in 2012-13. This accounts for around 2 per cent of all charity income.

Figure 7

The total cost of tax reliefs in real terms has increased since the introduction of Gift Aid in 1990

Repayments of tax to charities and tax reliefs provided to individuals, 1990-91 to 2012-13



Notes

1 Figures are adjusted for inflation to 2012-13.

2 Data includes tax repayments to charities, Higher Rate relief to individuals, and Gift of Shares and Securities relief to individuals. HMRC does not hold time series data on the value of Corporate Gift Aid after 1999-2000, following changes to this relief in 2000.

3 Reliefs on Gift Aid and Gift of Shares were introduced in 1990 and 2000 respectively.

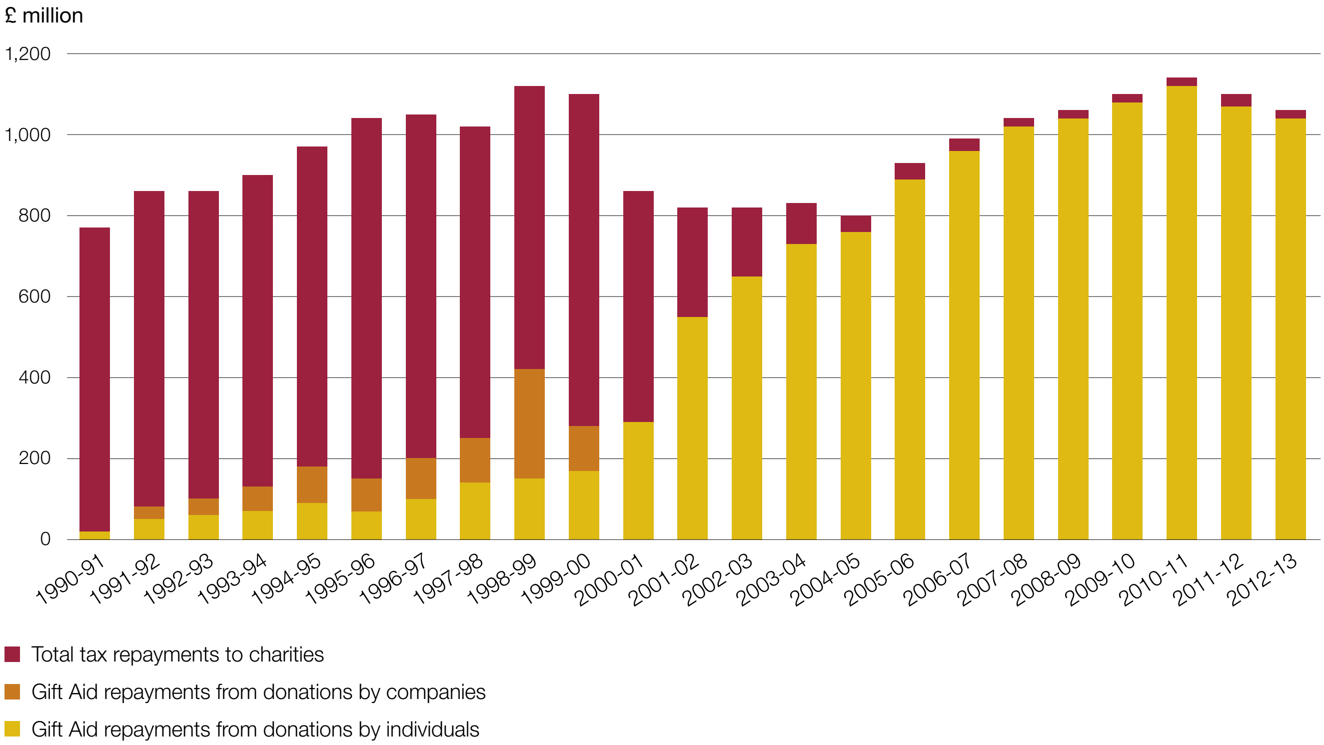
Source: National Audit Office analysis of HM Revenue & Customs *UK Charity Tax Relief Statistics* available at: www.hmrc.gov.uk/statistics/charity.htm, accessed 23 October 2013

1.9 HMRC has made repayments of tax to charities primarily through Gift Aid relief since government expanded that relief in 2000. Previously, charities received other types of tax repayments, as shown in **Figure 8**. These included deeds of covenant which provided tax relief for regular, fixed donations to charity over a period of at least three years. Gift Aid replaced covenants as a more flexible and accessible relief for donors. The total value of reliefs on donations paid to charities has fluctuated over time. In real terms, the amount paid to charities in respect of reliefs on donations increased between 1990 and 1999 but fell following changes made to Gift Aid and reliefs on donations in 2000. They have since risen to over £1 billion a year, similar in real terms to their value in the late 1990s before these changes took effect. Prior to 2000, tax repayments to charity included Gift Aid from donations made by companies. The changes made in 2000 redirected this relief to the donor, and so this component of the reliefs is not included in the data – which shows only the tax repaid to charities – after 1999-2000. The trading subsidiaries of charities that donate their profits as a Corporate Gift Aid donation will make use of this relief, although HMRC does not have a reliable estimate of the value of this benefit for the period since 2000.

Figure 8

Tax repayments on donations to charities over time have fluctuated

The value of Gift Aid repayments from donations by individuals has increased



Notes

1 Figures are adjusted for inflation to 2012-13 prices.

2 Following Budget 2000, company donations are paid gross and do not involve tax repayments and hence are excluded.

Source: National Audit Office analysis of HM Revenue & Customs *UK Charity Tax Relief Statistics* available at: www.hmrc.gov.uk/statistics/charity.htm, accessed 23 October 2013

1.10 Stakeholders we spoke to said that donors respond positively to Gift Aid reliefs paid to charity as it allows donors to increase the value of donations to the charity at no additional cost to themselves. Stakeholders identified this as an essential fundraising tool.

HMRC's monitoring of the reliefs

1.11 There is no clear framework that sets out how HMRC and HM Treasury should evaluate significant changes to reliefs, such as the changes in 2000. When introducing reliefs or making changes to those that exist, they need adequate data and information to evaluate changes and understand their costs and benefits. In 2000, there was a commitment from the exchequer that "the impact of the new measures, and in particular the administrative costs for charities, will be fully monitored and evaluated once they are up and running."[3]

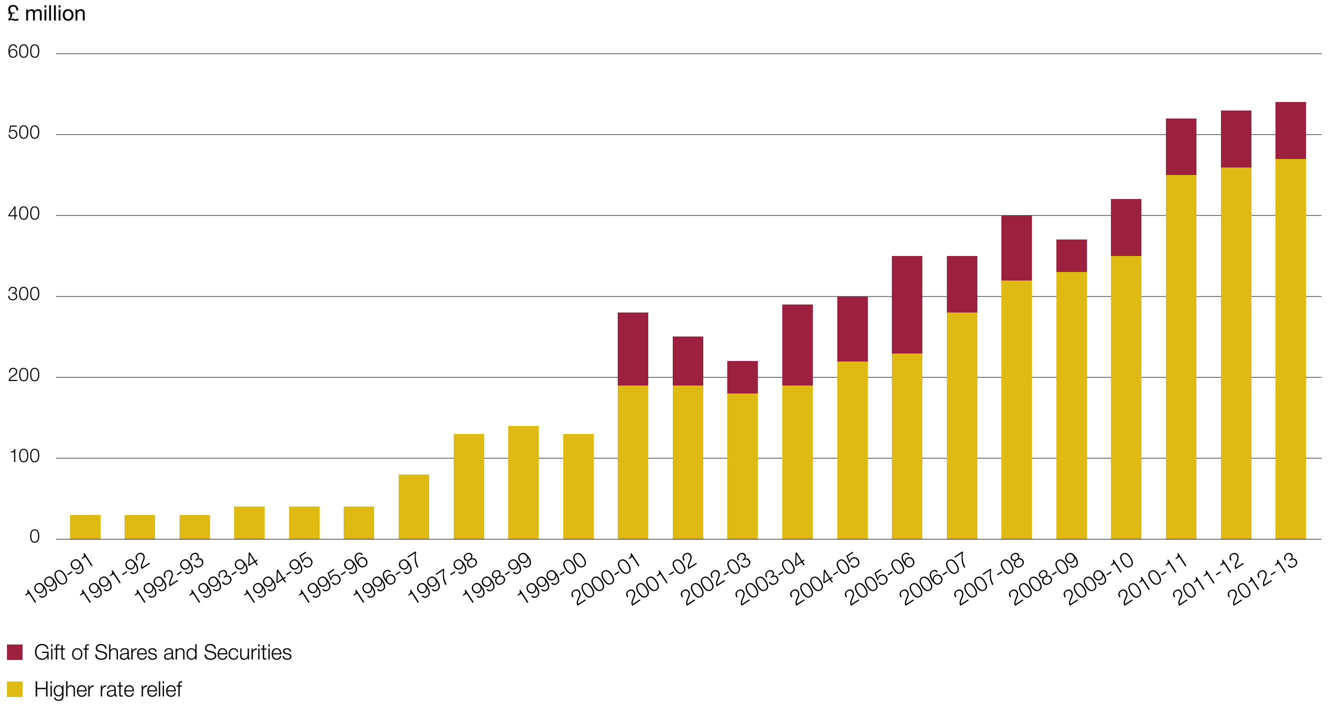
3 Inland Revenue, *Final regulatory impact assessment: Getting Britain giving in the 21st Century*, 2000, available online at: www.hmrc.gov.uk/ria/ria_giving.pdf. Accessed 14 November 2013.

Reliefs provided to individuals and companies on their donations

1.12 In total, Gift Aid and reliefs on donations cost £2 billion in 2012-13, of which around half went to individuals and companies. The value of tax reliefs provided to individuals has increased since the changes made in 2000, which aimed to encourage more giving to charity by broadening access to tax reliefs on donations (**Figure 9**). HMRC does not record the trends for Corporate Gift Aid since 2000. Until recently companies did not have to report this figure separately in their corporation tax return and as a consequence HMRC has incomplete cost data for this relief. HMRC's internal estimate is that in 2012-13 Corporate Gift Aid cost around £400 million. In 1999-2000, prior to the changes, the cost of providing reliefs to donors was around £130 million. In 2012-13, it had risen in total to around £940 million. The amount of relief paid to charities was £1,060 million in 1999-2000 prior to the changes, and £1,040 million in 2012-13 (Figure 8).

Figure 9
Tax reliefs to individuals

The value of tax reliefs provided to individuals on their donations and gifts has steadily increased



Note

1 Figures are adjusted for inflation to 2012-13.

Source: National Audit Office analysis of HM Revenue & Customs *UK Charity Tax Relief Statistics* available at: www.hmrc.gov.uk/statistics/charity.htm, accessed 23 October 2013

1.13 HMRC told us that they identified that tax administration data would not allow them to make a full assessment of changes to the design of the reliefs. Many donations do not have a tax consequence and HMRC and HM Treasury do not hold data on the total value and volume of donations over time. Third-party surveys on charitable donations provide some of this information, but they do not cover the whole period in which Gift Aid has operated.

1.14 In 2005 HMRC undertook an internal evaluation of the changes made in 2000, based on commissioned research and its own evaluation of administrative data. The evaluation found that the data HMRC collected were not robust enough to allow conclusions to be drawn about whether the reliefs provided to donors were an effective instrument through which to increase the value of donations. It found evidence to suggest that changes relating to companies may have had a negative effect on charities incomes and companies did not alter their donations in response to the changes in tax relief. HMRC identified at this time that it did not have data on which it could conclude a full evaluation.

1.15 In its 2005 evaluation HMRC set out ways to improve its evidence base and data sources, which it recognised as weak. For example, it was suggested that a data warehouse for charities data be established with the charitable sector, and that they could make greater use of existing national surveys.

1.16 HMRC has developed its evidence base by commissioning additional research and undertaking new analysis of internal data. The commissioned research includes examination of charitable giving and the likely effects on donations to charities of possible changes to Higher Rate relief. The scope of this work did not include the full range of areas a complete evaluation would address. It indicated that increasing the up front tax relief that charities can reclaim directly is a more effective way of increasing the total amount of money going to charity than changing the Higher Rate relief.

1.17 The changes made in 2000 reflect the general principle that charities' income that is used for charitable purpose is not taxed, by broadening access to tax reliefs on donations, including access to Higher Rate relief. Increased repayment of Gift Aid to charities suggests it has broadened access to the relief, as donors have found it easier to use than deeds of covenant. However, HMRC does not have sufficient evidence to conclude that the broader objective of encouraging more people to give more to charity has been achieved and that the reliefs provided to individuals and companies are effective at increasing the total value of donations to charities. Data and research from the charitable sector does not identify a significant change in trends in giving over this period in terms of the proportion of people who give and the amount they give. There is data that shows the total amount of donations from individuals has increased since 2000, but this might be explained by demographic and population changes rather than changes in patterns of giving. There is no evidence of a causal link between the changes to the reliefs and the value of donations.

Uptake of Gift Aid by charities and donors

1.18 HMRC recognises that the uptake of Gift Aid paid to charities could be higher, although it has not assessed what level of uptake is achievable. Our analysis of data on charitable giving in 2012 shows there are donations of around £2.3 billion where Gift Aid is not used. Not all of these donations will be eligible for Gift Aid purposes, for example if the donor does not pay tax, while some donors may not want HMRC to give this tax revenue to charity.

1.19 The use of Gift Aid by donors increases as the value of donations rise. The uptake of Gift Aid is highest where donations are greater than £100, although 94 per cent of donations are for less than this. We estimate that if the use of Gift Aid was increased among donors who give less than £100 by ten percentage points it could result in charities receiving an additional £94 million in relief, as shown in **Figure 10**. Based on our analysis, this would involve influencing the way in which around 2.5 million donors give.

1.20 HMRC has undertaken analysis to improve its understanding of the distribution of Gift Aid payments across charities. HMRC analysed payments to charities by the type of charitable causes they support using its internal data and that from charity regulators. This analysis suggested that in 2009-10 around 30 per cent of Gift Aid was received by charities carrying out religious activities and around 15 per cent by those carrying out education or training. The remainder was split across 12 other categories of charitable causes. HMRC's intention is that this analysis will aid future work looking at distributional impacts of Gift Aid.

Figure 10

The uptake of Gift Aid increases with size of donations

Increasing the uptake of Gift Aid relief by ten percentage points could result in an additional £94 million for charities

Value of donation	Percentage of donors (%)	Value as percentage of all donations (%)	Percentage of donors who use Gift Aid (%)	NAO analysis of the increase in Gift Aid relief if use rose by 10 percentage points (£m)
£10 or less	41	6	19	9
£10 – £25	31	16	43	25
£25 – £100	23	38	62	59
Over £100	6	40	80	–
Total	**100**	**100**		**94**

Note

1 We assume that uptake of Gift Aid on donations over £100 is close to the maximum uptake. Figures on total increase do not sum to £94 million due to rounding. Data in this table is sourced from *UK Giving 2012*, except for the final column which is the National Audit Office's analysis.

Source: Office for National Statistics survey data; National Council for Voluntary Organisations and Charities Aid Foundation, *UK Giving 2012. An overview of charitable giving in the UK, 2011/12*, November 2012. Available at: www.cafonline.org/PDF/UKGiving2012Full.pdf, accessed 23 October 2013

1.21 HM Treasury and HMRC have also undertaken research to understand barriers to the take-up of Gift Aid by charities and regularly consults with the charity sector. In 2013, HM Treasury consulted on proposals to make it easier to claim Gift Aid on donations made through digital channels. As part of this consultation HM Treasury asked for responses on what barriers to take-up of Gift Aid charities experience. HMRC and HM Treasury also hold regular meetings with stakeholders through HMRC's Charity Tax Forum.

1.22 HM Treasury and HMRC's engagement with the sector has informed decisions around changes to the administration of Gift Aid for charities. In 2013, HMRC launched the Gift Aid Small Donations Scheme to provide additional payments where Gift Aid is unclaimed. The scheme allows eligible charities to claim top-up payments on small cash donations where charities may find it difficult to collect a Gift Aid declaration, such as donations through charity bucket collections. For most eligible charities this could allow them to claim a top-up payment of up to £1,250 a year. HMRC estimates it will distribute £45 million in 2012-13 through this scheme, rising to £100 million by 2017-18.

Additional costs of the reliefs

1.23 Government wants tax reliefs to achieve particular outcomes, but individuals and organisations may use them in ways that Parliament did not intend. HMRC is responsible for identifying areas of potential misuse. This section considers the costs of:

- losses through avoidance, fraud and error; and
- administering the reliefs.

Losses through avoidance, fraud and error

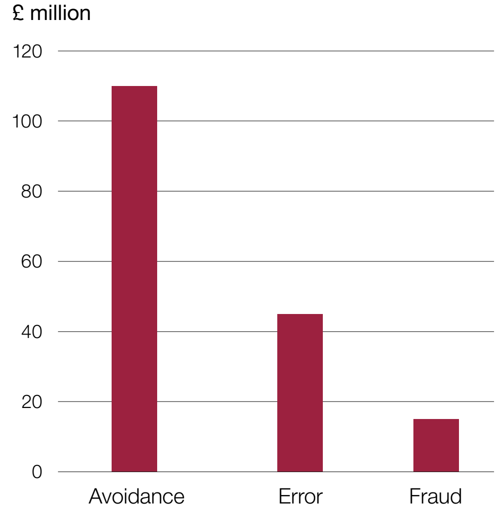
1.24 HMRC has established a working estimate of the losses for reliefs on donations. This is a separate exercise to HMRC's annual estimate of the overall tax gap, and is used to inform decisions about resource allocation. We have analysed HMRC's data, which indicates losses were £170 million in 2012-13, as shown in **Figure 11** overleaf. It intends to begin work on a full assessment of the losses across the reliefs covered in this report in autumn 2013.

1.25 As this is a working estimate, there are areas of potential loss which HMRC has yet to fully analyse and there are indications that the initial estimate is an underestimate. For example, we analysed survey data held by the Office for National Statistics on donors and donations. We identified what individuals said they donated, whether they said they used Gift Aid, and whether they were likely to have paid tax, given their reported income. Allowing for potential misreporting, we estimate that HMRC may pay at least £55 million a year to charities where donors have paid insufficient tax.

Figure 11

Estimated losses by category of risk, 2012-13

The tax losses are largest in the area of avoidance



	Avoidance	Error	Fraud	**Total**
Net tax loss (£m)	110	45	15	**170**
Percentage of tax loss (%)	65	26	9	**100**

Notes

1 The figures are after any activities HMRC has taken to reduce losses. The figures exclude tax at risk through marketed avoidance schemes as HMRC does not expect any of these claims to succeed. The analysis excludes reliefs such as business rates and VAT.

2 HMRC does not categorise its losses as 'avoidance', 'error' or 'fraud'. The split is based on National Audit Office analysis of the recorded figures.

Source: National Audit Office analysis of HM Revenue & Customs estimate

Tax at risk due to marketed avoidance schemes

1.26 Individuals or companies buy marketed tax avoidance schemes in the hope of benefiting from the tax advantage the scheme offers. The schemes often involve complex and contrived transactions.

1.27 HMRC has identified tax at risk totalling £240 million through marketed avoidance schemes that use reliefs on donations. This is the total tax revenue HMRC assesses might be lost should it not be successful in challenging what it considers to be avoidance activity related to marketed schemes. This figure has fallen as users, in part prompted by HMRC's investigations, have withdrawn 200 claims with a total value of £23 million. The tax at risk relates to ongoing investigations dating back to 2004.

Costs of administering the reliefs

1.28 HMRC's charities team, within its specialist personal tax directorate, is responsible for risks relating to the tax affairs of charities and managing HMRC's relationship with charity customers and the charity sector. The cost of administering Gift Aid relief has increased as HMRC has shifted its focus from processing claims as quickly as possible to tackling the risk of abuse. The cost of HMRC's charities team in 2012-13 was £9.7 million, an increase of 23 per cent since 2008-09. Staff numbers increased from 130 in 2009 to 185 in 2013. HMRC does not record separately the cost of processing the claims made by individuals or companies as part of their annual tax return.

1.29 Charities also incur a cost in administering their claims for Gift Aid relief, although no reliable estimate has been made by either the charitable sector or HMRC. Research conducted for HMRC and Charities Aid Foundation in 2008 reported that charities did not find claiming Gift Aid a simple process, but that Gift Aid was not the largest or hardest of their administrative duties. In 2013, HMRC launched Charities Online, which allows for quicker payments to charities of their Gift Aid claims and aims to reduce the administrative burden for charities.

Part Two

HMRC's response to abuse of the reliefs

2.1 This part examines:

- how reliefs on donations are abused;
- HMRC's response to these risks; and
- the outcomes HMRC achieves.

How reliefs on donations are abused

2.2 The reliefs provided by government are valuable to charities, but this has also made them attractive to fraudsters and tax avoiders, who have found a range of ways in which to exploit them. This creates a challenge to HMRC in detecting and preventing abuse. Those charities abusing their charitable status are largely unknown to the general public and do not receive public donations. While only a small number of charities are set up in order to abuse tax reliefs, the costs to HMRC of this abuse can be large.

2.3 This section examines how abuse may take place through fraud, avoidance and error.

Fraud

2.4 HMRC estimates that £15 million was lost through fraudulent claims in 2012-13. Fraudsters have targeted Gift Aid relief paid to charities. Unlike other reliefs on donations, Gift Aid claims from charities generate a cash repayment rather than reducing a claimant's tax liability.

2.5 HMRC have identified a number of ways in which fraudsters may operate. They may set up charities to facilitate fraud or hijack the details of a charity. They may then falsify donations in order to try and generate a repayment of Gift Aid relief. Fraudsters have also attempted to change the bank details of genuine charities held by HMRC by claiming to represent the charity. This would allow them to redirect payments of Gift Aid to a bank account they control.

2.6 There have also been cases of fraud being committed by individuals or companies abusing a position of influence they hold in an existing charity.

Avoidance

2.7 HMRC estimates that £110 million was lost in 2012-13 through avoidance using reliefs on donations. Tax avoidance involves using tax law to gain an advantage that Parliament did not intend. It often involves contrived or artificial arrangements, such as a circular flow of transactions. Individuals and companies may devise ways to avoid tax specific to their own circumstances, or they may pay a fee to participate in a marketed tax avoidance scheme.

2.8 Companies and individuals may try to avoid tax by donating to a charity that they control. They can do this by circulating money through the charity so that the individual or company retains the value of the donation, with limited benefit to charitable causes (**Figure 12**). The charity may distribute some money to meet its charitable aims, but the donor or a connected party receives a greater benefit. For example, HMRC is investigating one charity that spent most of its income on fundraising events, which involved the entertaining of the trustees' friends and family; and another that loaned more than £70 million to a number of companies connected to its trustee, with no arrangements which commit the companies to repay the charity.

Figure 12
Donor controlled charities

Companies or individuals may try to exploit reliefs on donations where they control a charity

How a charity controlled by a company may be used to exploit Corporate Gift Aid

- The management of the company and the charity overlap, or the company owners effectively control the trustees.
- The company donates profits to the charity and receives a reduction in its corporation tax bill through Corporate Gift Aid.
- The charity provides a loan to the donor company or to companies owned by the trustees. The company does not repay the loan.
- The charity may also distribute some money to causes fulfilling charitable obligations.

Example of a charity controlled by an individual and abuse of Higher Rate relief on Gift Aid

- An individual has control over the management of a charity as a trustee or has influence over the trustees.
- The individual makes a donation to the charity and claims Higher Rate relief on the donation. The charity also claims Gift Aid on the donation.
- The individual receives benefit from their donation. This could be in the form of an interest free loan from the charity. It may also be in the form of disguised non-charitable expenditure, such as entertaining, or paying substantial salaries to family members.
- The charity may distribute some money to causes fulfilling charitable obligations.

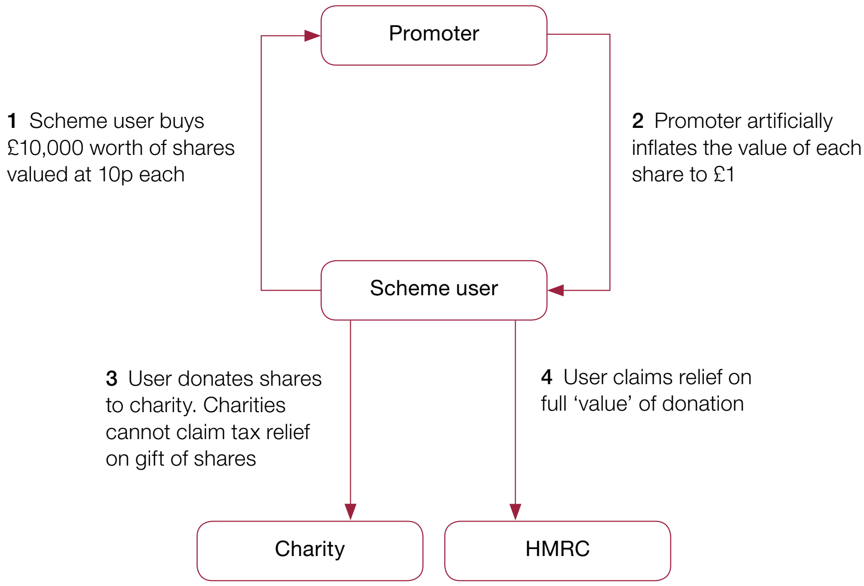
Source: National Audit Office analysis of HM Revenue & Customs information

Marketed tax avoidance schemes

2.9 In total HMRC has identified eight marketed schemes that use reliefs on donations, and three main designs by which these schemes operate, which are shown at **Figure 13, Figure 14** and **Figure 15** on page 30. **Figure 16** on page 31 shows the tax at risk across these three main types of scheme. In general they work by either by extracting the value of a donation and returning it to the donor, or by the true value of the donation being less than is claimed in relief. HMRC does not believe any of these schemes are effective and is challenging the claims made by their users.

Figure 13
Gift of shares: example of avoidance scheme

The charity receives shares that are in practice worthless



The promoter inflates the price of shares significantly beyond their true value. The scheme user donates these to a charity, but they may essentially be worthless. In some cases, charities have been unable to realise any value from these gifts as the stock exchange suspended the trading of these shares.

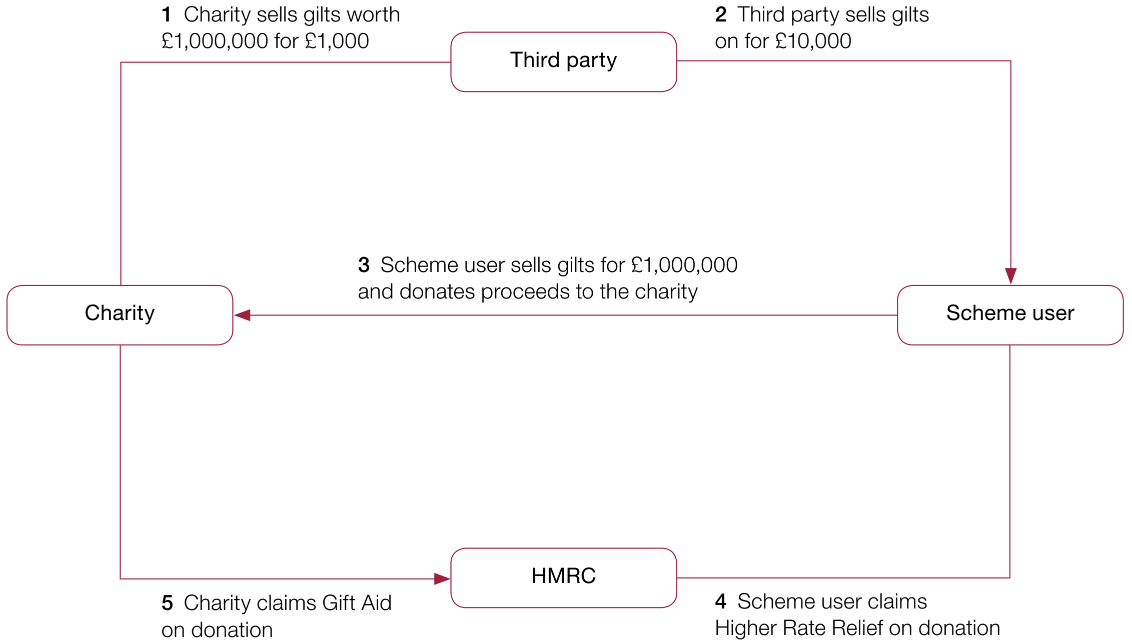
Notes

1 The scheme user buys £10,000 worth of shares in a company that are valued at 10p each.
2 The promoter floats the company on a stock exchange, manipulating trading activity to inflate the value of each share to £1.
3 The scheme user gifts their shares to a charity, stating a value of £100,000. In practice, the real value of the shares is much lower.
4 The scheme user then claims relief from HMRC on the £100,000 donation to charity.

Source: National Audit Office analysis of HM Revenue & Customs information

Figure 14
Gift of money: example of avoidance scheme

The charity is a complicit participant in a series of circular transactions



The promoter of the scheme controls the charity. There is a circular transaction of money involving the sale of gilts and the donation of proceeds from the sale to charity.

Notes

1 The charity takes out a loan to purchase gilts worth £1,000,000 that it then sells to a third party for £1,000. Gilts are not subject to capital gains tax.

2 The third party then sells the gilts on to the scheme user for £10,000.

3 The scheme user sells the gilts for the market value and donates the £1,000,000 to the charity with a Gift Aid declaration.

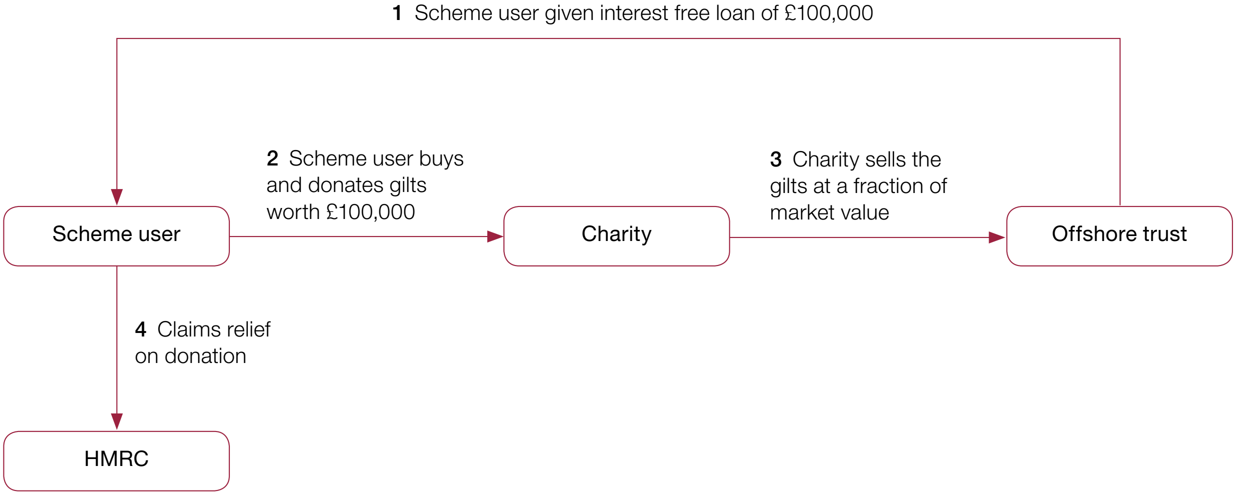
4 The scheme user claims Higher Rate relief between £250,000 and £312,500 on the £1,000,000 donation.

5 The charity uses the donation to repay the loan. It submits a claim to HMRC of £250,000 for Gift Aid relief.

Source: National Audit Office analysis of HM Revenue & Customs information

Figure 15
Gift of gilts: example of avoidance scheme

The charity receives a fee for participating in the scheme



The charity receives a fee for participating in the scheme. The users donate securities to the charity. The scheme extracts the value of the donations from the charity.

Notes
1 The promoter provides a scheme user with an interest free loan through an offshore trust.
2 The user buys gilts that they then donate to the charity. Gilts are not subject to capital gains tax.
3 The charity receives a fee for participating in the scheme. It sells the gilts at a fraction of market value to the offshore trust, which cancels the loan to the scheme user.
4 The scheme user claims relief on the value of the £100,000 donation.

Source: National Audit Office analysis of HM Revenue & Customs information

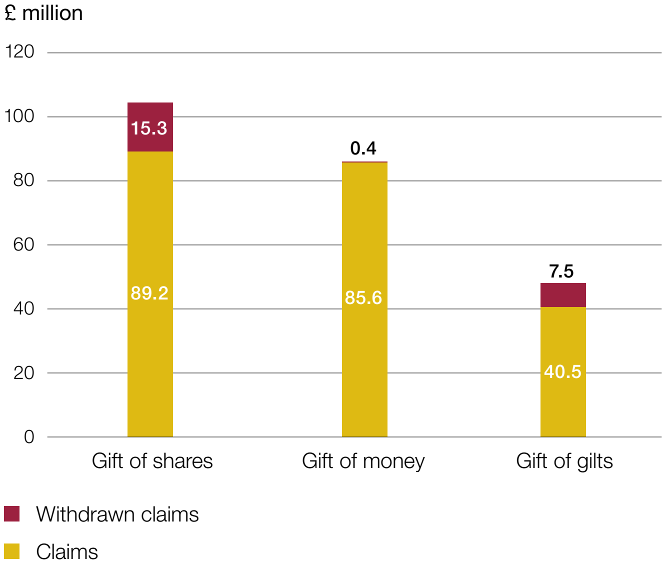
Error in Gift Aid

2.10 HMRC estimates that £45 million was lost in 2012-13 through errors on Gift Aid claims. Charities may make genuine mistakes in claiming Gift Aid relief. They may make mistakes in their claim, submit duplicate claims or submit a claim on a donation where the donor has not authorised the charity to claim Gift Aid. In 2012-13, charities contacted and repaid HMRC £2.5 million in claims that they had mistakenly claimed. Donors may also make mistakes. Some individuals who sign a Gift Aid declaration may not fully understand that they have to pay sufficient income or capital gains tax in the year of their donation for it to qualify for Gift Aid relief.

Figure 16

Tax at risk across the three types of marketed avoidance schemes

There was £240 million tax at risk, although claims to the value of £23 million were withdrawn[1]



Note

1 Tax at risk as at September 2013. These figures relate to claims dating from 2004 onwards.

Source: National Audit Office analysis of HM Revenue & Customs data

HMRC's response to the risks of abuse

2.11 This section covers:

- claiming Gift Aid and other tax reliefs;
- how claims are processed; and
- HMRC's approach to tackling fraud, avoidance and error.

Claiming Gift Aid and other tax reliefs

2.12 To access Gift Aid and other tax reliefs from HMRC, charities must first register, if necessary, with the appropriate regulator in England and Wales, Scotland or Northern Ireland. Charity regulators will consider if the organisation meets the legal definition of a charity, which requires that it has a charitable purpose and provides public benefit. They will also check that people named as trustees are eligible to act in that capacity and have not, for example, been disqualified from acting as a company director.

2.13 Legislation introduced in 2010 created a new definition of a ‘charity for tax purposes’. This helped deal with problems identified by HMRC’s internal audit, that there was an over reliance on the Charity Commission to spot fictitious charities and that HMRC was unable to effectively check the credibility of charities. Charity regulators do not have access to tax data held by HMRC. Unless HMRC disclosed information to the regulators through its statutory gateway, there was no mechanism by which to challenge people known by HMRC to have participated in tax avoidance or evasion.

2.14 Since April 2010, when the new legislation came into force, HMRC has been able to apply a ‘fit and proper persons’ test to the managers of charities. The legislation allows HMRC to refuse claims by charities for tax reliefs and exemptions where it has concerns about the individuals involved. This allows HMRC to deny relief, for example, where the trustees have participated in avoidance schemes or fraudulent activities.

2.15 HMRC have identified around 200 cases in which they questioned if the managers are ‘fit and proper’, refusing to recognise a charity for tax purposes or pay a Gift Aid claim until the charities answer relevant questions. None of the charities concerned have done so.

Processing claims

2.16 HMRC’s charities team is responsible for risks relating to the tax affairs of charities. HMRC receives around 150,000 Gift Aid claims a year from charities. Each claim may cover hundreds or thousands of individual donations. HMRC also receives around 35,000 claims for Corporate Gift Aid from businesses. HMRC does not have a current estimate of the number of individual taxpayers claiming Higher Rate relief on Gift Aid donations. It last estimated this in 2002-03. Applying this analysis to current data, we estimate the number is over 700,000.

2.17 HMRC processes these claims in different parts of its business:

- HMRC’s charities team process Gift Aid claims by charities.
- HMRC’s Personal Tax business area is responsible for administering the taxes paid by individuals, including reliefs on donations largely claimed through self-assessment tax returns.
- The Business Tax area is responsible for processing businesses’ corporate tax returns, in which Corporate Gift Aid may be claimed.

2.18 Where HMRC identifies concerns during processing it will examine the claims in greater detail (**Figure 17**). For example a large donation, which may involve substantial repayments of tax to a charity and reliefs claimed by an individual, may be reviewed by the charities team and HMRC's high net worth unit.

Figure 17

HMRC's charities team is responsible for charity tax reliefs, although high risk claims may also be examined by other areas of the business

Area of HMRC	Gift Aid relief	Higher Rate relief	Corporate Gift Aid	Gift of Shares and Securities
Charities team	✔	✔	✔	✔
Large business service			✔	✔
Local compliance		✔	✔	✔
High net worth unit		✔		✔
Affluent unit		✔		✔

Source: National Audit Office analysis of HM Revenue & Customs information

2.19 HMRC's charities team does not have oversight of or full information on all the checks that happen in other parts of HMRC. Since 2010, it has established projects to work with other areas of HMRC to improve its strategic management of the risks. However, there remains no requirement for other areas to provide it with information about relevant investigations or to identify the costs of or yields from interventions relating to charity reliefs.

2.20 Charity regulators may also hold information about charities, through their own reviews and investigations, which could help HMRC's assessment of claims. Responding to the potential misuse of charitable status therefore requires a close relationship between HMRC and the regulators of charities. Charity law and regulation is a devolved matter in Scotland and Northern Ireland.

2.21 HMRC's charities team has a memorandum of understanding with the Charity Commission to facilitate the sharing of information. Each has begun new investigations as a result of information passed from the other, and has used new information to further existing investigations.

2.22 However, neither the Charity Commission nor HMRC has shared all the information they could have done as specified in the memorandum. This has hindered some of both organisations' investigations. The Charity Commission has not told HMRC about all the statutory inquiries it has opened, and has not always communicated where it has identified significant non-charitable activity, or passed enough information to HMRC to indicate the full nature of its concern. Similarly, HMRC has not always passed indicators of non-charitable activity to the Charity Commission. HMRC has identified a small number of cases where further information from the Charity Commission would have saved them work in their fraud investigations or allowed them to address concerns sooner. In some cases, the Charity Commission receives information from HMRC but with constraints on its disclosure that mean the Charity Commission cannot use it in its investigations. Some of this arose because HMRC were not sure how much information it could share with the Charity Commission. It has now taken legal advice which suggested it could share more information. After HMRC had taken legal advice, the memorandum was revised in 2013 to widen the information shared.

2.23 HMRC also has a memorandum of understanding with the Office of the Scottish Charity Regulator and is looking to increase the exchange of information with this body. The Charity Commission for Northern Ireland is currently testing its registration process and plans to start registering charities from late 2013.

Strengthened countermeasures since 2009

2.24 Between around 2007 and 2009, HMRC's charities team placed greatest emphasis on improving processing times for Gift Aid payments to charities. HMRC's ability to identify and tackle avoidance fraud and error at this time was weak. It operated a 'pay now, check later' system, but it did not undertake sufficient checks. The checks that were undertaken on claims and changes to a charity's details were an insufficient deterrent to fraudsters and resulted in some Gift Aid repayments being hijacked and redirected.

2.25 HMRC recognised that a new approach was required. In 2009, it deployed new staff on the charities team to be responsible for assessing risk and tackling fraud. It introduced a strategy to tackle fraud in Gift Aid repayments and moved to a 'check now, pay later' approach.

2.26 HMRC also introduced new controls to strengthen its manual checks and tackle areas of weakness, putting greater focus on the first point of contact with charities and identifying high risk claims (**Figure 18**).

Figure 18

Controls introduced by HMRC's charities team to tackle risks since 2009

	2009	2010	2011	2012	2012	2013
Measure	Risk, fraud and compliance teams	New application form	Form to notify HMRC of change of details	Repayment security checks	Additional administrative checks	Charities online
Purpose	To risk assess and investigate claims for fraud, error and avoidance	Provides HMRC with additional information on charities	Provides HMRC with additional information it can check against records	To identify duplicate claims or those which contain errors	Various changes to administrative practices to ensure greater scrutiny and cross-checking of charity details. These changes help, for example, prevent fraudsters hijack the details of a charity	Inbuilt profiling of claims which can identify potential fraud and error
Risks tackled						
Avoidance	✔					
Fraud	✔	✔	✔	✔	✔	✔
Error	✔			✔		✔
Point at which risk is tackled						
Application	✔	✔			✔	✔
Already in system	✔		✔	✔	✔	✔

Source: National Audit Office analysis

2.27 In April 2013, HMRC launched a system to allow charities to claim Gift Aid online, called Charities Online. HMRC introduced this to improve the service to charities, but it has also helped HMRC to identify and stop fraud and error. The system checks data to information held elsewhere in HMRC, allowing, for example, the identification of mismatches to data already held by HMRC. It also allows for the automatic detection of trustees identified by HMRC as not 'fit and proper'.

Tackling fraud

2.28 Since 2009, HMRC has developed its understanding of fraudulent Gift Aid claims and behaviour. It has identified characteristics which may indicate fraud based on known cases to profile unusual or suspicious Gift Aid claims. By its nature fraud can be difficult to identify as fraudsters will attempt to disguise their claim or make it look like a genuine claim. Until 2013, HMRC assessed the risks manually which could not easily identify complex fraud or indicators of criminal attack. The system of online Gift Aid automatically assesses claims for indicators of fraud.

2.29 Amendments to the way in which HMRC provides reliefs, or extensions to them, sometimes provide an opportunity for fraud or tax avoidance. HMRC has not always identified these risks before legislation has been introduced. For example, government withdrew a measure designed to encourage charitable giving because it judged the cost of compliance work to counter fraudulent claims was greater than the benefits achieved. Self-Assessment Donate allowed individuals who were due a repayment of tax to donate this to a chosen charity. This was intended as a simplification of the rules, but in making this change it introduced the risk of abuse. HMRC did not fully assess the potential risk of abuse before the introduction of this measure, but having identified fraud it advised government to withdraw it (**Figure 19**).

Figure 19
Timeline of Self-Assessment Donate

Year	Description
2005	Introduction of Self-Assessment Donate. HMRC did not fully assess the potential for abuse at launch. There were no plans in place to formally assess the costs and benefits of the measure.
2009	Following investigation of a charity HMRC identified fraudulent use of the measure. Fraudsters had set up a charity in advance of creating false repayments. They instructed HMRC through Self-Assessment Donate to make the payment to the charity they controlled. One claim was for around £200,000, a larger amount than all genuine donations made that year. HMRC responded to the risk by checking all large claims. HMRC identified a criminal attack, which they believe was intended to test its controls.
2010	HMRC assessed that if the measure were to continue it would have to undertake compliance activities at a disproportionate cost to the benefits achieved through the measure.
2011	Government abolished the measure from the start of the 2012-13 tax year.

Source: National Audit Office analysis

2.30 HMRC now routinely assesses how it can counter potential fraud in the design of new measures. The government introduced the Gift Aid Small Donations Scheme in 2013 to allow charities to claim Gift Aid on cash donations under £20, where donors may not have the time to fill out a Gift Aid declaration form. In designing the rules, HMRC assessed the risk of abuse using its knowledge of previous frauds. It concluded the rules would deter fraudsters, without providing a disproportionate burden to genuine charities. HMRC intends to review how the scheme is working in 2016.

Tackling avoidance

2.31 When HMRC identifies tax avoidance, it challenges the taxpayer and where necessary pursues the case through litigation. It may also advise government on changes to tax law to prevent similar cases. **Figure 20** outlines the key pieces of legislation that government has introduced to tackle avoidance that exploits reliefs on donations.

Figure 20
Legislation introduced to tackle misuse of reliefs on donations

Year	Subject of legislation	Purpose of legislation
2004	Gift of Shares and Securities	Tackles avoidance schemes where the donor receives substantial tax relief but no real value remains with the charity (Figure 14). This legislation limits the value of tax relief of a donation to the net benefit to the charity.
2006	Substantial donors	Limits tax relief on substantial donations where the donor also has a controlling influence over the charity (Figure 13).
2010	Gift of Shares and Securities	Limits tax relief to the donor to the cost of acquiring the gift, where the main purpose of acquisition was to gift it to charity and claim tax relief (Figure 16).
2010	New definition of charity for tax purposes, including fit and proper test	Gives HMRC power to refuse claims for relief where the managers of charities are not ‘fit and proper’ persons. Introduced following a judgment in the European Court of Justice. This judgment requires HMRC to allow tax reliefs for charities in Europe, including Gift Aid relief on donations by UK taxpayers.
2011	Tainted charity donations	Tackles abuse where donors obtain a financial advantage from a charity in return for their donation (Figure 13). It replaces 2006 substantial donors legislation, which caught genuine donations and created a disproportionate administration burden for charities.

Source: National Audit Office analysis

2.32 HMRC has examined information on promoters and users of marketed avoidance schemes. It considers the changes to legislation in 2004 and 2010 have prevented more people using existing schemes and have deterred attempts to establish new schemes. HMRC believe the change enacted in 2010, which took effect from December 2009, stopped a scheme that was about to start. The promoter subsequently introduced a different scheme which HMRC has assessed does not work and therefore does not require a change to legislation.

Detecting avoidance

2.33 It is difficult for HMRC to detect avoidance activities undertaken by single individuals or companies that are not part of a marketed scheme. The arrangements may appear to represent typical financial transactions. They may involve moderate sums of money but over a long time period.

2.34 Over the last few years HMRC has developed its understanding of unusual or high risk behaviour. Gift Aid claim forms do not contain much information that HMRC can use in the profiling of charities for avoidance activity. HMRC has since 2010, examined charity tax returns to identify large debtors, unusual transactions and the ratio between expenditure and income. This analysis could not be undertaken using Gift Aid claims alone.

2.35 HMRC's profiling has relied on partial information of its customer base, as it does not currently hold key information on charities that would allow it to improve the focus of its risk assessments. It does not, for example, have a record of the income, expenditure and assets of charities. The Charity Commission holds some of this information and shares this with HMRC, although not all of the information is up to date and it does not cover all the charities HMRC works with. Assembling this information could, for example, help HMRC identify unusual loan arrangements or other indicators of potential misuse.

2.36 HMRC also assesses 7,000 to 10,000 charity tax returns a year, covering around 10 per cent of charities that have made recent Gift Aid claims. HMRC intends to increase its coverage of charities over the next few years to improve the quantity and quality of information it holds on customers. It has identified its largest customers which it will continue to examine more closely.

2.37 Understanding the customer base for reliefs on donations is important so that HMRC can identify wider changes in behaviour. The value of Corporate Gift Aid relief has increased significantly since government changed the relief so that companies could use donations to reduce their corporation tax liability, from £107 million in 1999-2000 to around £400 million in 2012-13. HMRC's data for 2012-13 is a rough estimate based on corporate tax returns and produced on a different basis to figures from 1999-2000. It does, however, suggest a significant growth in corporate giving, which does not correspond with trends in corporate donations reported by the charity sector. This could indicate a compliance risk. HMRC stopped reporting on Corporate Gift Aid in 2000 when the relief changed.

2.38 HMRC also works with charities on the technical interpretation of their tax affairs. These can cover a range of circumstances, including where there is genuine uncertainty about the correct tax treatment to the omission of relevant information in returns to HMRC.

Marketed tax avoidance schemes

2.39 HMRC's specialist investigations and local compliance teams investigate the users of marketed schemes. On becoming aware of a scheme HMRC is often reliant on the scheme users' tax returns – which it may receive 18 months later – before it can challenge a scheme and begin a full investigation. It can sometimes take several years for HMRC to collect evidence and explore legal arguments. HMRC will then litigate if necessary.

2.40 There are 1,800 open cases of people using marketed avoidance schemes which seek to exploit reliefs on donations. This is around 5 per cent of all marketed avoidance cases that HMRC has under investigation, and accounts for around 2 per cent of the value of all open cases.[4] It will take HMRC many years to resolve its investigations of the eight marketed schemes that use reliefs on donations. HMRC identified the earliest scheme under investigation in 2004 and the latest in 2011. HMRC do not expect any of the schemes to succeed when heard at tribunal.

2.41 Even cases that HMRC believe are not technically complicated cannot necessarily be resolved quickly. For one such scheme, HMRC are planning to resolve the cases, either by convincing users to withdraw their claims or through litigation, within five years of becoming aware of the scheme.

Tackling error

2.42 HMRC identified £4 million in duplicate claims by charities, which it stopped prior to payment or the charities returned when notified of the error. HMRC's new online system is able to identify and prevent duplicate payments. It also prevents arithmetical errors on claims that were previously possible.

2.43 HMRC undertakes checks that individuals have paid sufficient tax as part of their routine checks on charity claims, but this is a manual process that only covers a small part of the donor population. In late 2012, HMRC began an ongoing project to tackle this specific area of risk.

4 We reported on HMRC's approach to tackling marketed avoidance schemes in November 2012. Comptroller and Auditor General, *Tax Avoidance: tackling marketed avoidance schemes,* Session 2012-13, HC 730, National Audit Office, November 2012. We base the total number of open marketed avoidance cases on data from this report as HMRC does not have a more recent estimate. HMRC intends to produce by the end of December 2013 a plan showing how it will manage and reduce the stock of open cases.

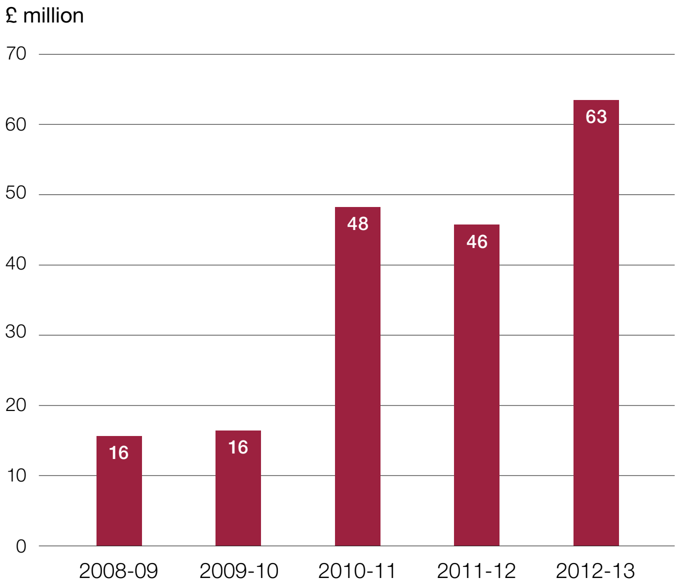
HMRC's performance in stopping losses

2.44 HMRC has increased the yields it records from its checks on Gift Aid claims by charities and its reviews of charity tax affairs. **Figure 21** shows that since HMRC adopted its new approach to tackling the risks, the yields have increased fourfold. HMRC does not identify separately the potential losses it stops from individuals claiming Higher Rate relief or companies claiming Corporate Gift Aid, so these are not included in the recorded yields.

2.45 The increase is a result not only of more resources, but also of an improved focus on areas of risk. In 2009-10, HMRC estimates that of the staff on its charities team undertaking checks, for every £1 in direct staff costs it saved £21 in tax revenue. In 2012-13, this had risen to £44. This compares well to HMRC's recent additional investment in compliance work across the wider department which has provided a marginal return of around 11:1.[5]

Figure 21
Yields from interventions

HMRC has increased the yields from its interventions



Notes

1 Figures are adjusted for inflation to 2012-13. HMRC does not record separately the yields from reviewing the tax position of individuals or companies which may result in identification of misuse of Higher Rate relief and Corporate Gift Aid.

2 Figures do not sum due to rounding.

Source: National Audit Office analysis of HM Revenue & Customs data

5 HL Committee of Public Accounts, *HM Revenue and Customs; Compliance and Enforcement Programme*, Eighty-Seventh Report of Session 2010–2012, HC 1892, May 2012.

2.46 Figure 22 shows our analysis of these yields by the categories of fraud, error and avoidance. HMRC's charities team does not itself routinely identify yields by these categories.

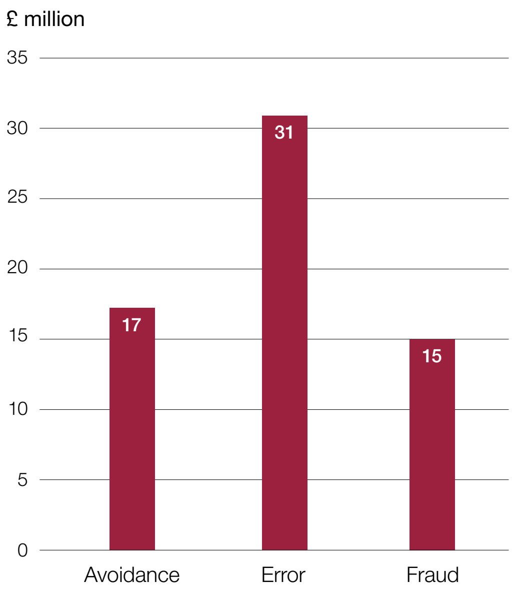
2.47 While staff numbers have increased, HMRC has not fully assessed if there are adequate resources in place to tackle the identified risks. Between 2009 and 2012, HMRC increased the number of staff involved in compliance activities in its charities team from 50 to 95. In 2012-13, in addition to routine checks, HMRC undertook risk-based reviews including 300 fraud interventions and 100 compliance interventions. HMRC also selects 400 charities a year for audit to ensure that they are using the Gift Aid scheme properly and their claims are accurate.

2.48 HMRC's charities team are considering revising its staffing model to increase the number of hours the staff tackling avoidance have to undertake investigations. This work requires experienced and skilled compliance staff. Changes would involve additional staff undertaking preliminary risk assessments. We modelled the potential impact of these changes and estimate HMRC could achieve around a 20 per cent increase in avoidance yields.

Figure 22

Yields by category of risk, 2012-13

Yields were £63 million, of which the majority came from tackling fraud and error[1]



Note

1 There are additional yields that HMRC do not currently record in a way that it can reliably attribute to Higher Rate relief and Corporate Gift Aid. The yields include losses from charities incorrectly stating their tax position, for example where there is a donor controlled charity. HMRC does not routinely identify whether its yield comes from 'avoidance', 'error' or 'fraud'. The split is based on National Audit Office analysis of their recorded figures.

Source: National Audit Office analysis of HM Revenue & Customs data

Appendix One

Our audit approach

1 In this study we examined how HMRC monitors and evaluates the effectiveness of reliefs on donations, and how it addresses tax avoidance, fraud and error relating to these reliefs. We examined:

- Whether HM Treasury and HMRC established clear measures to assess performance and how the effectiveness of the reliefs have been evaluated.
- If HMRC has a good understanding of the risks that individuals or charities use the reliefs in ways Parliament did not intend, and identifies the scale of the problem.
- If HMRC has developed an effective response to mitigating these risks.

2 We applied an evaluative framework to assess HMRC's understanding of the risks and the outcomes of HMRC's activities to reduce fraud, error and tax avoidance.

3 Our audit approach is summarised in **Figure 23**. Our evidence base is described in Appendix Two.

Figure 23
Our audit approach

The Department's objective

HMRC administers reliefs on donations, which are intended to support charities and encourage giving. HMRC has a strategic objective to improve the extent to which individuals and businesses pay the tax due and receive the credits and payments to which they are entitled.

How this will be achieved

HMRC and HM Treasury are responsible for monitoring the effectiveness of reliefs on donations. HMRC processes the claims for the reliefs and is responsible for putting measures in place to identify potential avoidance, fraud or error.

Our study

The study examined how HMRC tackles the risks of Gift Aid and reliefs on donations and how HMRC and HM Treasury monitored the effectiveness of these reliefs.

Our evaluative criteria

There are clear measures to assess performance. The reliefs have been monitored and evaluated.

HMRC has a good understanding of the risks and the scale of the problem.

HMRC has an effective response to mitigating these risks.

Our evidence

(see Appendix Two for details)

We assessed this by:

- **analysing** published statistics and data;
- **reviewing** HMRC papers and published research;
- **interviewing** relevant staff within HMRC and HM Treasury; and
- **examining charity tax law** legislation.

We assessed this by:

- **analysing HMRC management information**, including tax at risk and its estimate of losses;
- speaking with operational staff to **review and map processes** for identifying potential risks; and
- **reviewing case files** and management information to establish how HMRC identified specific cases of fraud and avoidance.

We assessed this by:

- **reviewing case examples** of specific cases of fraud and avoidance;
- **analysing HMRC's management information** of its compliance activities;
- **examining** HMRC's information of marketed avoidance schemes;
- **reviewing HMRC's controls** to prevent potential abuses; and
- **examining legislation** introduced to tackle avoidance.

Our conclusions

Gift Aid provides an important source of income for many charities. However, there is insufficient evidence that government actively encourages take-up of these reliefs. The effectiveness of changes made in 2000 to increase charitable giving is not proven. HMRC has improved its response to the risks of fraud, avoidance and error, but lacks a robust estimate of tax lost.

Appendix Two

Our evidence base

1 Our conclusions were reached following analysis of evidence collected between July and September 2013.

2 We assessed whether HMRC and HM Treasury established clear performance measures to assess and monitor the effectiveness of reliefs. We examined if the reliefs have been evaluated.

- We **analysed** HMRC's published statistics on charity tax reliefs. We examined survey data collected by the Office for National Statistics, as well as data reported by bodies from the charitable sector, such as the National Council for Voluntary Organisations. We express the value of reliefs over time in real terms to remove the effect of inflation. We used HM Treasury's deflators published 30 September 2013.
- We **reviewed HMRC documents and published research** about charity reliefs, including government consultation papers. Documentation relating to the original design of the reliefs were not available for review.
- We **interviewed** relevant staff within HMRC and HM Treasury. This included staff responsible for designing changes to these reliefs. We spoke to wider stakeholders, including representatives from the charitable sector and academics.
- We **examined how charity tax law has changed** from reviewing legislation since the introduction of Gift Aid in 1990.

3 We assessed if HMRC has a good understanding of the risks that individuals or charities use the reliefs in ways Parliament did not intend, and identifies the scale of the problem. We:

- **analysed HMRC management information**, including tax at risk from eight marketed avoidance schemes and its working estimate of losses from avoidance activities, fraud and error. We tested the reasonableness of the estimate;
- spoke with operational staff to **review and map processes** for identifying potential risks; and
- **reviewed case files** and management information to establish how HMRC identified specific cases of fraud and avoidance.

4 **We assessed if HMRC has developed an effective response to mitigating these risks. We:**

- **reviewed case files** to determine how HMRC tackled fraud and avoidance, the approaches it applied and money recovered;
- **analysed HMRC's management information and data** to assess its performance over time in tackling these risks. We undertook detailed analysis to align compliance activities to the risks of fraud, error and avoidance and examined progress against each of these categories;
- **examined** HMRC's identification of the number of users involved in eight marketed avoidance schemes. We reviewed case files of marketed avoidance schemes and the approaches applied by HMRC;
- **reviewed HMRC's controls** to assess how they prevent risks of fraud, error and avoidance. We interviewed those staff responsible for undertaking compliance activities and examined how the impact of this work is monitored; and
- **examined how HMRC has recommended changes to tax law** to prevent avoidance. We reviewed specific case examples where government introduced new legislation.

Appendix Three

Assessment of Gift Aid and reliefs on donations

1 In Figure 4 we outlined the characteristics of a well-designed, administered and evaluated tax relief. **Figure 24** outlines our assessment of Gift Aid and reliefs on donations, such as Higher Rate relief, Corporate Gift Aid and Gifts of Shares and Securities against these criteria.

Figure 24
Assessment of Gift Aid and reliefs on donations

Tax relief cycle	What good looks like	Assessment
Design	There is an adequate evidence base available to support decisions over design. The objectives and intended outcomes are clear and, where relevant, performance targets are set to reflect these. Option appraisal was undertaken.	Evidence of costs and benefits established at design were not available for our review. The broad objectives were stated. The intended outcomes and the overall distribution of benefits across the charity sector, individuals and companies are not clear. No performance measures were established when significant changes were made to the design of reliefs. Data required to evaluate changes to the design of reliefs were not collected.
Administration and monitoring	Process for delivering the relief is managed. Where performance targets are in place, these are monitored, reported and acted upon.	HMRC did not fully understand and tackle risks of abuse until after 2009. Prior to this HMRC was focused on speed of processing Gift Aid claims from charities. HMRC has not fully evaluated if the level of staffing reflects risk. No formal performance measures.
Evaluation and feedback	The relief is evaluated at appropriate intervals. Feedback from evaluation informs future management of relief and informs knowledge base to support decisions over the design of future tax reliefs.	The design of reliefs for individuals and companies have not been fully evaluated. There has not been a full evaluation of Gift Aid relief. Data was not collected that would allow full assessment of the effectiveness of tax reliefs on donations in meeting their objectives.

Source: National Audit Office analysis

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